

# World financial crisis: Questions & answers

## Financial market perspective

- How did we get into this situation and where do we go from here? CommSec examines the key issues.

### Is this as bad as 1987?

- The magnitude of the declines is similar but the 1987 experience is still worse than the current period. The drop from peak to trough in late 1987/early 1988 was far quicker as well.
- The Australian sharemarket peaked at 2376.88 on September 21 1987 and fell 49.2 per cent to its low point of 1207.51 on 10 February 1988 – a span of 103 days.
- In the current cycle, the All Ordinaries peaked at 6853.6 on November 1 2007 and has fallen 42.5 per cent to 3939.5 on October 10 2008 – a period of 243 trading days.

### How long did recovery take back in 1987?

- The sharemarket hit its lows in February 1988. Four months later the sharemarket had lifted by 36 per cent. A year after the lows, the market had lost some of those gains but was still up 29 per cent on the low point. However full recovery to the previous high took some time. In fact it took just over six years to get close to the previous highs but nine years to decisively push through the previous high. But the period did include a significant recession in 1991 and a slow economic recovery.
- In 1987 the sharemarket was significantly overvalued. In fact the price-earnings ratio hit 21.1, 79 per cent above the previous long-term average of 12.
- In the current cycle the PE ratio stood at 14.25 in November 2007 – below the previous decade average of 16.9 and the 28-year average of 15.2. The current PE ratio stands at 10.

### Biggest daily falls for the All Ordinaries index (pct)

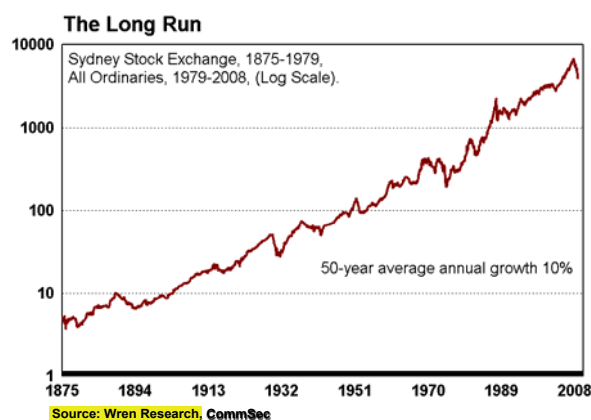
1	20-Oct-87	-25.0
2	<b>10-Oct-08</b>	<b>-8.2</b>
3	16-Oct-89	-8.1
4	29-Oct-87	-7.6
5	22-Jan-08	-7.3
6	23-Oct-87	-7.0
7	27-Oct-87	-6.9
8	10-Sep-73	-6.9
9	28-Oct-97	-6.8
10	26-Oct-87	-6.6
11	17-Apr-00	-5.7
12	26-Jun-72	-5.6
13	04-Nov-87	-5.5
14	29-Nov-60	-5.1
15	08-Oct-08	-5.0
16	17-Sep-01	-4.8
17	27-Sep-74	-4.6
18	11-Nov-87	-4.4
19	16-Nov-60	-4.4
20	30-Sep-08	-4.3
21	03-Jun-74	-4.3
22	27-Apr-73	-4.3
23	03-Mar-75	-4.3

Sydney All Ords before 1980

Source: CommSec

### Why caused the sharemarket to slide?

- It all began in the US. Bad lending practices led financial institutions to provide loans to people who shouldn't have got loans in the first place – sub-prime borrowers. Those loans were bundled up and turned into investments (securitised). These mortgage securities were also combined with other securities to try and reduce the risk (called collateralised debt obligations) and entice more investors to invest.
- Unfortunately when interest rates rose, sub-prime borrowers started to default. And the house of cards started to come down around the world.
- Financial institutions began to fail, causing banks and other institutions to become more wary about lending. Interbank



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